

CITY OF BALTIMORE  
WASTE WATER UTILITY FUND  
FINANCIAL STATEMENTS  
FOR THE YEARS ENDED  
JUNE 30, 2008 AND 2007  
(WITH REPORT OF INDEPENDENT AUDITORS THEREON)

CITY OF BALTIMORE  
WASTE WATER UTILITY FUND  
FINANCIAL STATEMENTS  
YEARS ENDED JUNE 30, 2008 AND 2007

TABLE OF CONTENTS

	<u>Page</u>
Report of Independent Auditors.....	1
Management's Discussion and Analysis .....	3-7
Statements of Net Assets.....	8
Statements of Revenues, Expenses, and Changes in Fund Net Assets.....	9
Statements of Cash Flows.....	10
Notes to the Financial Statements.....	11-28

CITY OF BALTIMORE

SHEILA DIXON, Mayor



DEPARTMENT OF AUDITS

ROBERT L. McCARTY, JR., CPA  
City Auditor

Room 321, City Hall  
Baltimore, Maryland 21202  
Telephone: 410-396-4783  
Telefax: 410-545-3961

**Report of Independent Auditors**

December 23, 2008

The Mayor, City Council, Comptroller and  
Board of Estimates of the City of Baltimore, Maryland

We have jointly audited the accompanying financial statements of the Waste Water Utility Fund of the City of Baltimore, Maryland, as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the City of Baltimore, Maryland's management. Our responsibility is to express an opinion on these financial statements based on our audits.

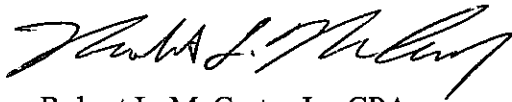
We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Waste Water Utility Fund's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Waste Water Utility's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Waste Water Utility Fund and do not purport to, and do not present fairly, the financial position of the City of Baltimore, Maryland, as of June 30, 2008 and 2007, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

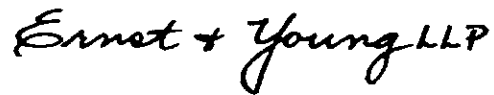
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Waste Water Utility Fund of the City of Baltimore, Maryland, as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.



The management's discussion and analysis on pages 3 through 7 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Robert L. McCarty, Jr., CPA  
City Auditor  
Department of Audits



Ernst & Young LLP  
Independent Auditors

**City of Baltimore  
Waste Water Utility Fund**

**Management's Discussion and Analysis**

This section of the City of Baltimore, Maryland's Waste Water Utility Fund (Waste Water Utility) financial statements presents our discussion and analysis of the Waste Water Utility's financial performance during the years ended June 30, 2008 and 2007.

**Background**

The Waste Water Utility, through its system of sanitary sewers, interceptors, pumping stations, and waste water treatment facilities, provides for the treatment and disposal of sanitary sewage flow of approximately two-thirds of the population of the Baltimore metropolitan area. The waste water system presently receives waste water directly from Anne Arundel and Baltimore Counties, as well as the City. In addition, portions of Anne Arundel and Howard Counties discharge waste water into the system through Baltimore County.

**Highlights**

- For fiscal year 2008, total operating revenues were \$157.9 million, which represents an increase of 4.3% over the previous year's revenues. For fiscal year 2007, total operating revenues were \$151.4 million, which represented an increase of 11.1% over the previous year's revenues.
- Total operating expenses for fiscal year 2008 were \$143.9 million, an increase of \$8.1 million over fiscal year 2007 operating expenses of \$135.8 million. Total operating expenses for fiscal year 2007 were \$135.8 million, an increase of \$.5 million over fiscal year 2006 operating expenses of \$135.3 million.
- Net assets increased in fiscal years 2008, 2007, and 2006 by \$41.4 million, \$69.4 million, and \$36.5 million, respectively.

**Overview of the Financial Statements**

This report consists of three parts: 1) management's discussion and analysis (this section), 2) financial statements, and 3) notes to the financial statements.

The financial statements provide both long-term and short-term information about the Waste Water Utility's overall financial status. The notes to the financial statements explain some of the financial information in the financial statements and provide more detailed information.

The Waste Water Utility's financial statements are prepared in conformity with accounting principles generally accepted in the United States as applied to governmental units on an accrual basis. Under this basis, revenues are recognized in the period in which they are earned, expenses are recognized in the period in which they are incurred, and depreciation of assets is recognized in the statement of revenues, expenses, and changes in fund net assets. All assets and liabilities associated with the operation of the Waste Water Utility are included in the statement of net assets.

### Financial Analysis of the Waste Water Utility

<b>Statements of Net Assets</b> <b>Waste Water Utility Fund</b> <i>(Expressed in Thousands)</i>					
	<b>2008</b>	<b>June 30, 2007</b>	<b>2006</b>	<b>Change 2008-2007</b>	<b>Change 2007-2006</b>
Current and other assets .....	\$ 286,618	\$ 343,631	\$ 249,956	\$ (57,013)	\$ 93,675
Capital assets .....	1,438,880	1,319,816	1,182,393	119,064	137,423
Total assets .....	<u>1,725,498</u>	<u>1,663,447</u>	<u>1,432,349</u>	<u>62,051</u>	<u>231,098</u>
Current liabilities .....	65,711	88,381	70,805	(22,670)	17,576
Noncurrent liabilities .....	630,710	587,373	443,291	43,337	144,082
Total liabilities .....	<u>696,421</u>	<u>675,754</u>	<u>514,096</u>	<u>20,667</u>	<u>161,658</u>
Net assets:					
Invested in capital assets, net of related debt .....	799,255	727,916	732,353	71,339	(4,437)
Restricted .....	137,784	236,173	156,071	(98,389)	80,102
Unrestricted .....	92,038	23,604	29,829	68,434	(6,225)
Total net assets .....	<u>\$ 1,029,077</u>	<u>\$ 987,693</u>	<u>\$ 918,253</u>	<u>\$ 41,384</u>	<u>\$ 69,440</u>

### Analysis of the Statements of Net Assets

Net assets may serve as a useful indicator of the Waste Water Utility's financial position. For the Waste Water Utility, assets exceeded liabilities by \$1,029.0 million, \$987.7 million, and \$918.3 million in fiscal years 2008, 2007, and 2006 respectively. The Waste Water Utility's net assets include its investment of \$799.3 million, \$727.9 million, and \$732.4 million in capital assets (e.g., land, buildings, and equipment), less any related outstanding debt used to acquire those assets, at the end of fiscal years 2008, 2007, and 2006, respectively. The Waste Water Utility uses these capital assets to provide waste water services to citizens; consequently, these assets are not available for future spending. Although the Waste Water Utility's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from customers of the Waste Water Utility through rates and charges, since the capital assets themselves cannot be liquidated for these liabilities. An additional portion of the Waste Water Utility's net assets, \$137.8 million, represents restricted resources that are legally obligated for the acquisition and improvement of capital facilities and revenue bond repayment requirements. The Waste Water Utility had unrestricted net assets of \$92.1 million, \$23.6 million, and \$29.8 million as of June 30, 2008, 2007, and 2006, respectively.

During fiscal years 2008, 2007, and 2006, the Waste Water Utility expended \$144.2 million, \$155.7 million, and \$80.3 million for capital assets. These assets primarily represent expenditures for facility enhancements to comply with environmental regulations. The assets were funded primarily through new issues of revenue bonds of \$56.6 million, \$153.3 million, and \$87.0 million in fiscal years 2008, 2007, and 2006, respectively. Fitch Ratings, Moody's Investor Services, Inc., and Standard & Poor's Rating Services gave the Series 2008 Bonds insured ratings of AAA, Aaa, and AAA, respectively.

**Statements of Revenues, Expenses, and Changes in Fund Net Assets**  
**Waste Water Utility Fund**  
*(Expressed in Thousands)*

	Year Ended June 30,			Change	Change
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008-2007</u>	<u>2007-2006</u>
Operating revenues .....	\$ 157,974	\$ 151,462	\$ 136,405	\$ 6,512	\$ 15,057
Operating expenses:					
Salaries and wages .....	34,611	30,813	30,517	3,798	296
Other personnel costs .....	13,638	12,381	11,657	1,257	724
Contractual services .....	60,594	59,653	60,125	941	(472)
Material and supplies .....	9,757	8,030	11,243	1,727	(3,213)
Depreciation .....	25,256	24,953	21,793	303	3,160
Total operating expenses .....	143,856	135,830	135,335	8,026	495
Operating income .....	14,118	15,632	1,070	(1,514)	14,562
Non-operating income (expense) .....	214	32	(582)	182	614
Income before capital contributions .....	14,332	15,664	488	(1,332)	15,176
Capital contributions .....	27,052	53,776	36,002	(26,724)	17,774
Change in net assets .....	41,384	69,440	36,490	\$ (28,056)	\$ 32,950
Beginning net assets (as restated) ...	987,693	918,253	881,763		
Ending net assets .....	\$ 1,029,077	\$ 987,693	\$ 918,253		

**Analysis of the Statements of Revenues, Expenses, and Changes in Fund Net Assets**

The overall increase in the Waste Water Utility's net assets amounted to \$41.4 million, \$69.4 million, and \$36.5 million for fiscal years 2008, 2007, and 2006, respectively. These increases are due to improved operating margins that resulted from the implementation of a 4% waste water rate increase in fiscal year 2008, and 9% waste water rate increases in both fiscal years 2007 and 2006, to customers located in Baltimore

City, and increased capital contributions, primarily from Baltimore County, corresponding to increases in the cost of the Capital Improvement Program.

## Capital Assets

The Waste Water Utility's capital assets as of June 30, 2008, 2007, and 2006 amounted to \$1,438.9 million, \$1,319.8 million, and \$1,182.4 million (net of accumulated depreciation), respectively. Capital assets include land, equipment, buildings, and improvements. Total increases in the Waste Water Utility's net capital assets for fiscal years 2008, 2007, and 2006 were \$119.1 million, \$137.4 million, and \$92.3 million, respectively. These increases were funded primarily by issuance of revenue bonds. The following schedule presents the capital asset activities for fiscal years 2008, 2007, and 2006 (amounts expressed in thousands):

	Balance June 30, 2008	Net Change	Balance June 30, 2007	Net Change	Balance June 30, 2006
Land .....	\$ 8,931		\$ 8,931		\$ 8,931
Buildings and improvements .....	814,224	\$ (10,567)	824,791	\$ 3,577	821,214
Equipment .....	21,607	(936)	22,543	(2,363)	24,906
Construction in progress .....	594,118	130,567	463,551	136,209	327,342
Total capital assets, net .....	<u>\$ 1,438,880</u>	<u>\$ 119,064</u>	<u>\$ 1,319,816</u>	<u>\$ 137,423</u>	<u>\$ 1,182,393</u>

As of June 30, 2008, the Waste Water Utility had commitments of \$159.2 million for the acquisition and construction of capital assets. See Note 6 for further information.

## Debt Administration

For fiscal years 2008, 2007, and 2006, the Waste Water Utility had long-term obligations of \$635.3 million, \$591.9 million, and \$449.6 million, respectively. These long-term obligations consisted primarily of revenue bonds, which are secured by revenue derived from the treatment of waste water. The Waste Water Utility also issued \$56.6 million in revenue bonds to fund the cost of acquisition and construction of various capital projects. During fiscal years 2008, 2007, and 2006, the Waste Water Utility's debt increased by \$43.2 million, \$142.1 million, and \$78.9 million respectively. See Note 7 for further information.

## Economic Condition of the Waste Water Utility

The Waste Water Utility is a large regional utility system that provides for the treatment and disposal of sanitary sewage flow for the diverse Baltimore metropolitan area, which includes Baltimore City, as well as portions of Baltimore, Anne Arundel, and Howard Counties. Modest growth is expected in the future. The Waste Water Utility has ample long-term wastewater treatment capacity. The Waste Water Utility is currently under a consent decree with the U.S. Environmental Protection Agency to eliminate sanitary and combined sewer overflows. Although the Waste Water Utility is expected to make substantial investments in capital improvements to meet Clean Water Act and consent



decree requirements, management expects continued good financial performance, including adequate debt service coverage and liquidity. On May 28, 2008, the City Board of Estimates approved a 4% annual rate increase for Baltimore City effective May 29, 2008. Increased costs of wastewater service are passed along to the counties under the terms of agreements with Baltimore and Anne Arundel counties.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Statements of Net Assets**  
**June 30, 2008 and June 30, 2007**  
(Expressed in Thousands)

Assets:	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents.....	\$ 83,651	\$ 62,748
Accounts receivable, net:		
Service billings.....	27,000	31,983
Due from other funds.....		7,000
Due from other governments.....	21,991	3,426
Inventories.....	166	198
Current restricted assets:		
Cash and cash equivalents.....	143,386	154,855
Investments.....		3,737
Accounts receivable, net.....	7,849	77,581
Total current assets.....	<u>284,043</u>	<u>341,528</u>
Noncurrent assets:		
Capital assets not being depreciated.....	603,049	472,482
Capital assets, net of accumulated depreciation .....	835,831	847,334
Unamortized bond issuance costs.....	2,575	2,103
Total noncurrent assets.....	<u>1,441,455</u>	<u>1,321,919</u>
Total assets.....	<u>1,725,498</u>	<u>1,663,447</u>
Liabilities:		
Current liabilities:		
Accounts payable and accrued liabilities.....	8,092	6,502
Accrued interest payable.....	8,983	4,055
Due to other funds.....		23,666
Due to other government.....		4,468
Compensated absences and other liabilities.....	9,733	4,227
Revenue bonds payable.....	13,480	13,028
General long-term debt payable.....	987	415
Accounts payable from restricted assets.....	24,436	32,020
Total current liabilities.....	<u>65,711</u>	<u>88,381</u>
Noncurrent liabilities:		
Revenue bonds payable, net.....	620,164	576,895
Compensated absences.....	2,473	2,640
Unamortized bond premiums.....	7,438	6,277
General long-term debt payable.....	635	1,561
Total noncurrent liabilities.....	<u>630,710</u>	<u>587,373</u>
Total liabilities.....	<u>696,421</u>	<u>675,754</u>
Net assets:		
Invested in capital assets, net of related debt.....	799,255	727,916
Restricted for:		
Debt service.....	55,120	53,248
Future capital additions .....	82,664	182,925
Unrestricted.....	92,038	23,604
Total net assets.....	<u>\$ 1,029,077</u>	<u>\$ 987,693</u>

The notes to the financial statements are an integral part of this statement.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Statements of Revenues, Expenses, and Changes in Fund Net Assets**  
**For the Years Ended June 30, 2008 and June 30, 2007**  
(Expressed in Thousands)

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Charges for sewer services (net of bad debts of \$349 for fiscal year 2008 and \$1,302 for fiscal year 2007) .....	\$ 157,974	\$ 151,462
Operating expenses:		
Salaries and wages.....	34,611	30,813
Other personnel costs.....	13,638	12,381
Contractual services.....	60,594	59,653
Materials and supplies.....	9,757	8,030
Depreciation.....	25,256	24,953
Total operating expenses.....	<u>143,856</u>	<u>135,830</u>
Operating income .....	<u>14,118</u>	<u>15,632</u>
Nonoperating revenues (expenses):		
Investment income .....	7,245	4,736
Interest expense .....	(7,031)	(4,704)
Total nonoperating income .....	<u>214</u>	<u>32</u>
Income before capital contributions .....	14,332	15,664
Capital contributions.....	27,052	53,776
Changes in net assets.....	41,384	69,440
Total net assets - beginning .....	987,693	918,253
Total net assets - ending.....	<u>\$ 1,029,077</u>	<u>\$ 987,693</u>

The notes to the financial statements are an integral part of this statement.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Statements of Cash Flows**  
**For the Years Ended June 30, 2008 and June 30, 2007**  
(Expressed in Thousands)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Receipts from customers.....	\$ 214,124	\$ 142,462
Receipts from interfund services provided.....		9,000
Payments to employees.....	(47,827)	(41,097)
Payments to suppliers.....	(87,603)	(69,410)
Payments for interfund services used.....		(7,000)
Net cash provided by operating activities.....	<u>78,694</u>	<u>33,955</u>
Cash flows from capital and related financing activities:		
Proceeds from revenue bonds.....	56,711	214,135
Principal paid on bonds.....		(138)
Principal paid on revenue bonds.....	(13,343)	(71,650)
Acquisition and construction of capital assets.....	(144,320)	(155,734)
Capital contributions.....	27,052	53,776
Net cash provided (used) by capital and related financing activities.....	<u>(73,900)</u>	<u>40,389</u>
Cash flows from investing activities:		
Interest received.....	7,582	4,200
Interest paid.....	(6,679)	(6,280)
Proceeds from the sale and maturities of investments.....	3,737	
Net cash provided (used) by investing activities.....	<u>4,640</u>	<u>(2,080)</u>
Net increase in cash and cash equivalents.....	9,434	72,264
Cash and cash equivalents, beginning of year.....	217,603	145,339
Cash and cash equivalents, end of year.....	<u>\$ 227,037</u>	<u>\$ 217,603</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income .....	\$ 14,118	\$ 15,632
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense.....	25,256	24,953
Changes in assets and liabilities:		
Accounts receivable.....	56,150	(2,687)
Due from other governments.....	7,000	
Inventories.....	32	(6)
Other assets .....		(2,103)
Accounts payable and accrued liabilities.....	1,590	(8,720)
Other liabilities.....	870	2,084
Accrued interest payable.....	4,928	9
Restricted accounts payable.....	(7,584)	9,358
Due to other funds.....	(23,666)	(4,565)
Total adjustments.....	<u>64,576</u>	<u>18,323</u>
Net cash provided by operating activities.....	<u>\$ 78,694</u>	<u>\$ 33,955</u>

The notes to the financial statements are an integral part of this statement.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

**1. Description of the Utility**

The Waste Water Utility Fund is a separate utility in the Bureau of Water and Waste Water, one of the three bureaus in the City of Baltimore, Maryland's Department of Public Works. In November 1978, the voters approved a Charter Amendment establishing the Waste Water Utility as a separate enterprise and requiring it to be financially self-sustaining and operated without profit or loss to the other funds or programs of Baltimore City (City).

These financial statements are only of the Waste Water Utility and are not intended to present the financial position, changes in financial position, or, where applicable, cash flows of the City.

**2. Summary of Significant Accounting Policies**

The accounting and financial reporting policies of the Waste Water Utility conform to accounting principles generally accepted in the United States and reporting standards as promulgated by the Governmental Accounting Standards Board for enterprise funds.

The Waste Water Utility has elected not to follow Financial Accounting Standards Board pronouncements issued after November 30, 1989.

*Basis of Accounting*

The financial statements have been prepared on the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Operating revenues result from the services provided by the Waste Water Utility, and all other revenue is considered non-operating.

*Cash and Cash Equivalents*

Cash and cash equivalents include demand deposits, as well as short-term investments with a maturity date within three months of the date acquired by the Waste Water Utility.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

*Investments*

Investments are reported at fair value on the date of the Statement of Net Assets, based on market prices. Investments with maturities of less than one year from purchase date are reported at cost, which approximates fair value. Securities traded on national exchanges are valued at the last reported sales price.

*Swaps*

Interest Rate Swaps are entered into to take advantage of lower cost interest rates, through conversion of variable rate to fixed rates and fixed rate to variable rates. It is the policy of the Waste Water Utility to not record the fair value of the swap arrangements. Swap related transactions are recorded as payments are received and made. Note 9 provides more information on the various rewards and risks typical to these types of financing arrangements.

*Inventories*

Inventories are stated at cost, using the moving average cost method.

*Unbilled Waste Water Utility User Charges*

Unbilled waste water user charges are estimated and accrued at year-end.

*Restricted Assets*

The proceeds of the Waste Water Utility revenue bonds, Federal and State grants, and restricted accounts receivable are restricted for the purpose of the construction of Waste Water facilities and revenue bond repayment requirements.

*Use of Restricted Net Assets*

When an expense is incurred for which restricted and unrestricted resources are available to pay the expense, it is the Waste Water Utility's policy to apply the expense first to restricted resources, then to unrestricted resources.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

*Capital Assets*

Purchased or constructed capital assets are reported at historical cost. Capitalization thresholds are \$250,000 for buildings, improvements, and infrastructure; and \$5,000 for equipment.

Capital assets are depreciated using the straight-line method over the estimated useful lives, as follows:

Buildings.....	50 years
Improvements.....	20-50 years
Equipment.....	2-25 years
Mobile Equipment.....	5-10 years

*Amortization*

Bond issuance costs are amortized over the life of the issue using the straight-line method, the effect of which is not materially different than under the effective interest method. Gains and losses on the early extinguishment of debt are amortized over the shorter of the life of the new or old debt.

*Sick, Vacation, and Personal Leave*

Employees earn one day of sick leave for each completed month of service; there is no limitation on the number of sick leave days that may be accumulated. A portion of unused sick leave earned annually during each twelve month base period may be converted to cash for a maximum of three days, computed on an attendance formula.

Upon retirement with pension benefits, or termination of employment after completion of twenty or more years of service without pension benefits, employees receive one day's pay for every four sick leave days accumulated and unused as of the date of separation; under any other conditions of separation, unused sick leave is forfeited. At June 30, 2008, it is estimated that accumulated non-vested sick leave for the Waste Water Utility approximated \$2,100,000. Sick leave benefit expenses are recorded as a percent of conversion value based on years of service, with a maximum of 100% for employees with twenty years or more of service.

Employees can accumulate a maximum of 224 vacation and personal leave days depending upon length of service, which may be taken either through time off or carried until paid upon termination or retirement. Accumulated vacation and personal leave expenses are recorded when leave is earned.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

The total vacation, personal leave, and conversion value of unused sick leave recorded as a liability for compensated absences at June 30, 2008 and 2007 is \$6,698,000 and \$6,867,000, respectively.

*Due to Other Governments*

Effective January 1, 2005, the State of Maryland implemented a Bay Restoration Fee to provide funding for the upgrade of waste water treatment facilities in the State. The fee is collected quarterly by the local government and remitted to the State. At June 30, 2008 and 2007, the Waste Water Utility held \$5,507,000 and \$4,468,000, respectively, in fees due to the State.

**3. Deposits and Investments**

The Waste Water Utility participates in the City's pooled cash account. At June 30, 2008 and 2007, the Waste Water Utility's share of the City's pooled cash account, including both restricted and unrestricted cash, was \$81,108,000 and \$55,015,000, respectively. All of the City's pooled cash deposits are either insured through the Federal Depository Insurance Corporation or collateralized by securities held in the name of the City by the City's agent.

For other than pension funds, the City is authorized by state law to invest in direct or indirect obligations of the United States Government, repurchase agreements that are secured by direct or indirect obligations of the United States Government, certificates of deposit, commercial paper with highest letter and numerical rating, and mutual funds registered with the Securities and Exchange Commission. The City's investment policy limits the percentage of certain types of securities, with the exception of obligations for which the United States Government has pledged its full faith and credit. For investments held by the City in trust and/or to secure certain debt obligations, the City complies with the terms of the trust agreements. The City's Board of Finance has formally adopted the above policies, and reviews and approves all security transactions.

The Waste Water Utility's investments at June 30, 2008 and 2007 are presented in the following table. All investments are presented by investment type, and debt securities are presented by maturity (amounts expressed in thousands):



**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

June 30, 2008	Fair	<u>Investment Maturities (In Months)</u>		
Investment Type	Value	Less than 6	6 to 12	Greater than 12
Debt Securities:				
U.S. Agencies .....	\$ 15,715	\$ 15,715		
Money market mutual funds .....	126,964	126,964		
Commercial paper .....	3,249	3,249		
	145,928	\$ 145,928		
Less: Cash equivalents .....	145,928			
Total investments .....				

June 30, 2007	Fair	<u>Investment Maturities (In Months)</u>		
Investment Type	Value	Less than 6	6 to 12	Greater than 12
Debt Securities:				
U.S. Agencies .....	\$ 2,835	\$ 2,835		
Repurchase Agreements .....	3,737			\$ 3,737
Money market mutual funds .....	158,341	158,341		
Commercial paper .....	1,413	1,413		
	166,326	\$ 162,589		\$ 3,737
Less: Cash equivalents .....	162,589			
Total investments .....	\$ 3,737			

*Interest rate risk* – Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of the investments. The City limits its interest rate risk in accordance with the City’s Board of Finance policy by maintaining a minimum of 20 percent of the City’s investment in funds in liquid investments, to include United States Government securities, and by limiting the par value of the portfolio invested for a period greater than one year at or below \$100 million. The Waste Water Utility is in compliance with this policy.

*Credit risk of debt securities* – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. As discussed above, the City’s Board of Finance limits City investments to only the highest rated investments in the categories discussed above. The Waste Water Utility’s portions of the City’s rated debt investments as of June 30, 2008 and 2007, were rated by a nationally recognized statistical rating agency, and are presented below using the Standard and Poor’s rating scale (amounts expressed in thousands):

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

June 30, 2008		Quality Ratings	
Investment Type	Fair Value	AAA	A1 - P1
Debt Securities:			
U.S. Agencies .....	\$ 15,715	\$ 15,715	
Money market mutual funds:			
M&T Bank US Government Money Market Fund ...	126,964	126,964	
Commercial paper .....	3,249		\$ 3,249
Total rated debt investments .....	<u>\$ 145,928</u>	<u>\$ 142,679</u>	<u>\$ 3,249</u>

June 30, 2007		Quality Ratings	
Investment Type	Fair Value	AAA	A1 - P1
Debt Securities:			
U.S. Agencies .....	\$ 2,835	\$ 2,835	
Repurchase agreements:			
Underlying securities .....	3,737	3,737	
Money market mutual funds:			
M&T Bank US Government Money Market Fund ...	158,341	158,341	
Commercial paper .....	1,413		\$ 1,413
Total rated debt investments .....	<u>\$ 166,326</u>	<u>\$ 164,913</u>	<u>\$ 1,413</u>

**4. Allowance for Doubtful Accounts**

Accounts receivable are shown net of a \$5,676,000 allowance for fiscal year 2008 and a \$6,064,000 allowance for fiscal year 2007.

**5. Interfund Balances and Activity**

Balances due to/from other funds at June 30, 2007 (amounts expressed in thousands):

Fund	Interfund	
	Receivable	Payable
Capital .....	\$ 23,666	
Water .....		\$ 7,000
Waste Water .....	7,000	23,666
Totals .....	<u>\$ 30,666</u>	<u>\$ 30,666</u>

The interfund balances are primarily the result of the City's policy not to reflect cash deficits in individual funds. Also, at June 30, 2007 certain transactions between funds relating to capital financing had not been completed.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

**6. Capital Assets**

Capital assets activity for the years ended June 30, 2008 and 2007 were as follows (expressed in thousands):

	Balance June 30, 2007	Increases	Decreases	Balance June 30, 2008
Capital assets not being depreciated:				
Land .....	\$ 8,931			\$ 8,931
Construction in progress .....	463,551	\$ 173,951	\$ 43,384	594,118
Total capital assets not being depreciated .....	472,482	173,951	43,384	603,049
Capital assets being depreciated:				
Buildings and improvements .....	1,143,509	11,364		1,154,873
Equipment .....	91,490	2,389		93,879
Total capital assets being depreciated .....	1,234,999	13,753		1,248,752
Less: accumulated depreciation for:				
Buildings and improvements .....	(318,718)	(21,931)		(340,649)
Equipment .....	(68,947)	(3,325)		(72,272)
Total accumulated depreciation .....	(387,665)	(25,256)		(412,921)
Total capital assets being depreciated, net .....	847,334	(11,503)		835,831
Total capital assets, net .....	\$ 1,319,816	\$ 162,448	\$ 43,384	\$ 1,438,880

	Balance June 30, 2006	Increases	Decreases	Balance June 30, 2007
Capital assets not being depreciated:				
Land .....	\$ 8,931			\$ 8,931
Construction in progress .....	327,342	184,063	\$ 47,854	463,551
Total capital assets not being depreciated .....	336,273	184,063	47,854	472,482
Capital assets being depreciated:				
Buildings and improvements .....	1,118,317	25,192		1,143,509
Equipment .....	90,515	975		91,490
Total capital assets being depreciated .....	1,208,832	26,167		1,234,999
Less: accumulated depreciation for:				
Buildings and improvements .....	(297,103)	(21,615)		(318,718)
Equipment .....	(65,609)	(3,338)		(68,947)
Total accumulated depreciation .....	(362,712)	(24,953)		(387,665)
Total capital assets being depreciated, net .....	846,120	1,214		847,334
Total capital assets, net .....	\$ 1,182,393	\$ 185,277	\$ 47,854	\$ 1,319,816

Interest is capitalized on assets acquired with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest costs incurred from the date of the borrowing until completion of the project, with interest earned on invested proceeds over the same period. During fiscal years 2008 and 2007, interest cost of \$15,036,000 and \$7,024,000 respectively (net of interest earned of \$5,717,000 and \$4,528,000 respectively) was capitalized.

At June 30 2008, the Waste Water Utility had outstanding commitments for construction of \$159,169,000.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

**7. Long-term Obligations**

The Constitution of Maryland requires a three-step procedure for the creation of debt by the City of Baltimore:

- Act of the General Assembly of Maryland or resolution of the majority of Baltimore City delegates
- Ordinance of the Mayor and City Council of Baltimore
- Ratification by the voters of the City of Baltimore

Changes in long-term obligations for the years ended June 30, 2008 and June 30, 2007 are as follows (amounts expressed in thousands):

	Balance June 30, 2007	Additions	Reductions	Balance June 30, 2008	Amounts Due Within One Year
General obligation bonds payable (a) .....	\$ 1,615	\$ 67	\$ 352	\$ 1,330	\$ 914
Long-term financing with State of Md. (b) ..	<u>361</u>		<u>69</u>	<u>292</u>	<u>73</u>
Total general long-term debt .....	\$ <u>1,976</u>	\$ <u>67</u>	\$ <u>421</u>	\$ <u>1,622</u>	\$ <u>987</u>
Revenue bonds .....	\$ 593,368	\$ 56,615	\$ 13,029	\$ 636,954	
Less: unamortized charges .....	<u>3,445</u>		<u>135</u>	<u>3,310</u>	
Total revenue bonds payable .....	\$ <u>589,923</u>	\$ <u>56,615</u>	\$ <u>12,894</u>	\$ <u>633,644</u>	\$ <u>13,480</u>
Compensated absences .....	\$ <u>6,867</u>		\$ <u>169</u>	\$ <u>6,698</u>	\$ <u>4,227</u>

	Balance June 30, 2006	Additions	Reductions	Balance June 30, 2007	Amounts Due Within One Year
General obligation bonds payable (a) .....	\$ 1901	\$ 82	\$ 368	\$ 1,615	\$ 347
Long-term financing with State of Md. (b) ..	<u>425</u>		<u>64</u>	<u>361</u>	<u>68</u>
Total general long-term debt .....	\$ <u>2,326</u>	\$ <u>82</u>	\$ <u>432</u>	\$ <u>1,976</u>	\$ <u>415</u>
Revenue bonds .....	\$ 449,804	\$ 213,564	\$70,000	\$ 593,368	
Less: unamortized charges .....	<u>1,945</u>	<u>1,655</u>	<u>155</u>	<u>3,445</u>	
Total revenue bonds payable .....	\$ <u>447,859</u>	\$ <u>211,909</u>	\$ <u>69,845</u>	\$ <u>589,923</u>	\$ <u>13,028</u>
Compensated absences .....	\$ <u>6,536</u>	\$ <u>331</u>		\$ <u>6,867</u>	\$ <u>4,227</u>

(a) These general obligation bonds bear interest rates ranging from 4.70% to 7.50% and mature serially through 2011.

(b) Under the provisions of Chapter 445, Laws of Maryland, 1968, and Chapter 286, Laws of Maryland, 1974, loans were made available to counties and municipalities charged with providing sewerage facilities to assist in the construction of such facilities. These loans bear interest ranging from 6.10% to 8.19%, and interest of \$48,000 will be due thereon in future years.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

The following is a schedule of the principal and interest payments required as of June 30, 2008 to service the above general long-term debt payable by the Waste Water Utility until maturity (amounts expressed in thousands):

	<u>General Obligation Bonds</u>		<u>Long-Term Financing with State of Maryland</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2009.....	\$ 913	\$ 31	\$ 73	\$ 19
2010.....			77	14
2011.....	417	118	82	9
2012.....			60	6
Total.....	<u>\$1,330</u>	<u>\$ 149</u>	<u>\$292</u>	<u>\$ 48</u>

The City has issued revenue bonds, the proceeds of which were used to provide funds for capital improvements to waste water facilities. Assets with a carrying value of \$55,120,000 at June 30, 2008, and certain revenues of the Waste Water Utility are pledged as collateral for the bonds and notes. Bonds and notes outstanding as of June 30 consist of (amounts expressed in thousands):

	<u>2008</u>	<u>2007</u>
Serial bonds series 1993-A maturing in annual installments from \$1,010,000 to \$1,250,000 through July 1, 2008, with interest ranging from 5.1% to 5.5%, payable semiannually .	\$ 1,250	\$ 2,430
Serial bonds series 1994-A maturing in annual installments from \$485,000 to \$590,000 through July 1, 2009, with interest ranging from 4.6% to 5.0%, payable semiannually .	1,150	1,685
Serial bonds series 1994-B maturing in annual installments from \$332,000 to \$406,000 through February 1, 2015, with interest rate at 2.25%, payable semiannually.....	2,658	3,005
Serial bonds series 1994-C maturing in annual installments from \$310,000 to \$387,000 through February 1, 2015, with interest rate at 2.5%, payable semi-annually.....	2,519	2,845
Serial bonds series 1994-D maturing in annual installments from \$215,000 to \$296,000 through February 1, 2015, with interest rate at 3.6%, payable semiannually.....	1,865	2,096

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

	<u>2008</u>	<u>2007</u>
Serial bonds series 1996-B maturing in annual installments from \$148,000 to \$208,000 through February 1, 2017, with interest rate at 3.17%, payable semiannually.....	1,659	1,816
Serial bonds series 1998-A maturing in annual installments from \$287,000 to \$414,000 through February 1, 2019, with interest rate at 2.87%, payable semiannually.....	3,973	4,277
Serial bonds series 1999-A maturing in annual installments from \$122,000 to \$167,000 through February 1, 2019, with interest rate at 2.52%, payable semiannually.....	1,635	1,763
Serial bonds series 1999-B maturing in annual installments from \$433,000 to \$652,000 through February 1, 2021, with interest rate at 2.61%, payable semiannually.....	6,737	7,204
Serial bonds series 2001-A maturing in annual installments from \$569,000 to \$819,000 through February 1, 2022, with interest rate at 2.3%, payable semiannually.....	9,741	10,336
Serial bonds series 2002-A maturing in annual installments from \$1,660,000 to \$1,145,000 from July 1, 2009 through July 1, 2021, with variable interest through July 1, 2016 and a fixed rate of 4.85 – 5.0% thereafter, payable semiannually .....	18,925	18,925
Serial bonds series 2003-A maturing in annual installments from \$1,930,000 to \$2,095,000 from July 1, 2023 through July 1, 2025, with interest ranging from 4.125% to 4.2% payable semiannually .....	6,035	6,035
Serial bonds series 2003-B maturing in annual installments from \$308,000 to \$984,000 through February 1, 2024, with interest rate at 0.40%, payable semiannually .....	4,807	5,117
Serial bonds series 2004-B maturing in annual installments from \$917,000 to \$984,000 through February 1, 2024, with interest rate at 0.45%, payable semiannually .....	15,278	16,201
Serial bonds series 2004-C maturing in annual installments from \$846,000 to \$984,000 through February 1, 2023 with interest rate at 0.25%, payable semiannually .....	14,094	14,945
Serial bonds series 2005-A maturing in annual installments from \$984,000 to \$1,030,000 through February 1, 2024 with interest rate at 0.25%, payable semiannually .....	18,295	19,333
Serial bonds series 2005-B maturing in annual installments from \$750,000 to \$1,010,000 from July 1, 2007 through July 1, 2016 with interest rates of 3.25% to 5.0%, payable semiannually .....	16,665	17,415

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

	<u>2008</u>	<u>2007</u>
Term bonds series 1993-A with interest at 5.6%, payable semiannually, due July 1, 2013 .....	7,100	7,100
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020 .....	14,000	14,000
Term bonds series 1994-A with interest at 6.0%, payable semiannually, due July 1, 2015.....	4,330	4,330
Term bonds series 1994-A with interest at 5.0%, payable semiannually, due July 1, 2022 .....	7,115	7,115
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2023.....	2,470	2,470
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2027.....	6,070	6,070
Term bonds series 2002-A with interest at 5.2%, payable semiannually, due July 1, 2032.....	9,480	9,480
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2042.....	31,630	31,630
Auction rate notes series 2002-B, payable monthly, due July 1, 2032 .....	25,300	25,300
Auction rate notes series 2002-C, payable monthly, due July 1, 2032 .....	47,400	47,900
Auction rate notes series 2004-A, payable weekly, due July 1, 2034 .....	17,500	17,500
Serial bonds series 2005-C maturing in annual installments from \$599,000 to \$735,000 through July 1, 2012 with interest rate at 0.70%, payable semiannually .....	2,761	3,390
Serial bonds series 2006-A maturing in annual installments from \$1,380,000 to \$1,561,000 through February 1, 2026 with interest rate at 0.40%, payable semiannually .....	27,162	28,615
Serial bonds series 2006-B maturing in annual installments from \$338,000 to \$362,000 through February 1, 2026 with interest rate at 0.40%, payable semiannually .....	6,302	6,640
Serial bonds series 2006-C maturing in annual installments from \$990,000 to \$2,090,000 from July 1, 2009 through July 1, 2026, with interest rates of 4.0% to 5.0%, payable semiannually.....	26,105	26,105
Term bonds series 2006-C with interest at 5.0%, payable semiannually, due July 1, 2029 .....	6,920	6,920

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

	<u>2008</u>	<u>2007</u>
Serial bonds series 2007-A maturing in annual installments from \$1,833,000 to \$2,184,000 through February 1, 2026, with interest rate at 0.4%, payable semiannually .....	38,002	39,835
Serial bonds series 2007-B maturing in annual installments from \$134,000 to \$161,000 through February 1, 2027, with interest rate at 0.4%, payable semiannually .....	2,956	3,090
Serial bonds series 2007-C maturing in annual installments from \$35,000 to \$3,935,000 from July 1, 2009 through July 1, 2027, with interest rates of 3.6% to 4.5%, payable semiannually .....	11,090	11,090
Term bonds series 2007-C with interest at 4.5%, payable semiannually, due July 1, 2032 .....	29,795	29,795
Term bonds series 2007-C with interest at 4.5%, payable semiannually, due July 1, 2036 .....	19,255	19,255
Serial bonds series 2007-D maturing in annual installments from \$1,890,000 to \$4,330,000 from July 1, 2010 through July 1, 2027, with interest rate at 5.0%, payable semiannually .....	53,140	53,140
Term bonds series 2007-D with interest at 5.0%, payable semiannually, due July 1, 2032 .....	25,120	25,120
Term bonds series 2007-D with interest at 5.0%, payable semiannually, due July 1, 2037 .....	32,050	32,050
Serial bonds series 2008-A maturing in annual installments from \$475,000 to \$1,005,000 from July 1, 2009 through July 1, 2028, with interest rates of 2.00% to 5.00%, payable semiannually .....	28,835	
Term bond series 2008-A with interest at 5.0%, payable semiannually, due July 1, 2033 .....	12,205	
Term bond series 2008-A with interest at 5.0%, payable semiannually, due July 1, 2038 .....	15,575	
	<hr/> 636,954	<hr/> 593,368
Less: unamortized charges.....	3,310	3,445
	<hr/> \$ 633,644	<hr/> \$ 589,923

At June 30, 2008, the Waste Water Utility fund had \$90,200,000 of auction rate notes. Interest rates for these notes are determined every 7 to 35 days depending on the date of issue. In the event of a failed auction, the auction agent assesses the failed auction rate to the issuers of the notes. Interest paid under these conditions is currently limited to 150% to 175% of the non-financial commercial paper rate depending on the rating of the insurance provider on each note



**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

issue. At December 31, 2008 the failed auction interest rate on these notes was in the 1% range or less.

Principal maturities and interest on revenue bonds are as follows (amounts expressed in thousands):

Fiscal year	Principal	Interest	Interest Rate Swap Net (a)
2009.....	13,480	22,441	2,426
2010.....	16,822	23,327	2,443
2011 .....	19,663	22,848	2,487
2012 .....	20,166	22,284	2,525
2013 .....	20,079	21,693	2,562
2014-2018 .....	109,154	98,628	12,827
2019-2023 .....	115,086	80,654	10,804
2024-2028 .....	106,455	61,627	7,395
2029-2033 .....	112,255	38,738	3,016
2034-2038 .....	81,550	14,997	95
2039-2042 .....	22,244	2,824	
	<u>\$636,954</u>	<u>\$410,061</u>	<u>\$46,580</u>

- (a) Interest rate swap net payments represent estimated payments for additional interest resulting from swap agreements to counterparties. The additional payments were computed using interest rates as of June 30, 2008, assuming current interest rates remain the same for the entire term of the bonds. As rates vary, variable rate bond interest payments and net swap payments will vary.

The Waste Water Utility has various revenue bond covenants that generally require the Utility to maintain rates sufficient to meet the operating requirements of the Utility and an operating reserve as defined in the revenue bond indentures. As of June 30, 2008, the rate requirements were met, and management believes the Waste Water Utility is in compliance with all significant requirements of the indentures.

## **8. Pledged Revenue**

The Waste Water Utility Fund has pledged future customer revenues to repay \$636,954,000 of revenue bond debt. Proceeds from these revenue bonds were used to build and improve various aspects of the City's Waste Water Utility systems. The bonds are payable solely from the revenues of the Waste Water Utility Fund and are payable through 2042. Annual principal and interest payments on these revenue bonds are expected to require 16% of pledged revenues. Total principal and interest remaining to be paid on the revenue bonds for the Waste Water Utility Fund is \$1,093,595,000. Principal and interest paid for the current year and current pledged revenue for the Waste Water Utility Fund were \$26,545,000 and \$157,974,000, respectively.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

**9. Prior-Year Defeasance of Debt**

In prior years, the City defeased certain revenue bonds by placing the proceeds of new debt issues in an irrevocable trust to provide for all future debt service payments on the old debt. Accordingly, the trust account assets and the liability for the defeased debt are not included in the Waste Water Utility's financial statements. At June 30, 2008, \$129,400,000 of debt outstanding is considered defeased.

**10. Interest Rate Swaps**

*Objectives of the swaps* - The City has entered into swaps for three reasons: First, the majority of its swaps have been used to create synthetic fixed rate financings (by issuing floating-rate bonds and swapping them to fixed) as a way to provide lower-cost fixed rate financing to meet the City's capital needs. Second, the City has used swaps from fixed to floating to help the City manage its balance sheet for an appropriate mix of fixed and floating rate exposure. And, third, the City has used basis swaps to amend the floating rate on certain of its existing synthetic fixed rate swaps in order to provide a better hedge on the underlying floating rate bonds.

*Terms, fair value, and credit risk* - The terms, fair value, and credit risk rating of the outstanding swaps, as of June 30, 2008, were as follows. The notional amounts of the swaps match the principal amount of the associated debt. The City's swap agreements contain scheduled reductions to outstanding notional amounts that are designed to track the scheduled or anticipated reductions in the associated "bonds payable" category.

Outstanding Bonds	Effective Date	Termination Date	Interest Rate Paid by City	Interest Rate Received	Notional Amount	Fair Value	Counterparty Credit Rating
<i>Fixed to Floating Swaps:</i>							
1993 Revenue Bonds	1/1/2008	7/1/2020	SIFMA Index	5.54%	\$ 2,507,350	\$ (51,281)	AA+/Aa2
1994 Revenue Bonds	1/1/2008	7/1/2024	SIFMA Index	5.26%	1,229,550	(40,915)	AA+/Aa2
1998 Revenue Bonds	2/1/2001	7/1/2028	SIFMA Index	5.17%	22,705,000	604,438	AA+/Aa2
1998 Revenue Bonds	7/1/2008	7/1/2028	SIFMA Index	5.08%	1,876,278	(89,684)	AA+/Aa2
2000 Revenue Bonds	7/1/2003	7/1/2030	SIFMA Index	5.70%	1,855,869	(56,628)	AA+/Aa2
<i>Floating to Fixed Swaps:</i>							
1998 Revenue Bonds	10/26/2001	7/1/2008	5.17%	SIFMA Index	*22,705,000	(334,007)	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2037	4.555%	SIFMA/67%LIBOR	72,700,000	(10,377,708)	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2009	3.87%	Bond Rate/CPI	1,660,000	41,657	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2010	4.00%	Bond Rate/CPI	1,785,000	48,982	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2011	4.10%	Bond Rate/CPI	1,820,000	57,233	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2012	4.20%	Bond Rate/CPI	1,930,000	61,619	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2013	4.30%	Bond Rate/CPI	1,960,000	63,654	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2014	4.39%	Bond Rate/CPI	2,040,000	54,669	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2015	4.50%	Bond Rate/CPI	1,240,000	24,087	A+/Aa3
2002 Revenue Bonds	5/7/2002	7/1/2016	4.61%	Bond Rate/CPI	1,280,000	20,508	A+/Aa3
2004 Revenue Bonds	6/1/2004	7/1/2034	5.21%	SIFMA Index	17,500,000	(3,199,367)	A+/Aa3
Grand Total Swaps Outstanding					<u>* \$156,794,047</u>	<u>\$(13,172,743)</u>	

\* Note: Notional principal total includes a swap that amended or partially reversed another swap previously entered into by the City. If this offsetting and amended swap is excluded, the notional principal total would be lower as follows: \$134,089,047.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

*Credit risk* - As of June 30, 2008, the City is exposed to credit risk on nine outstanding swaps because all of the other swaps have negative fair values. All fair values were calculated using the mark-to-market or par value method. However, should the interest rates change and the fair values of the swaps become positive, the City would be exposed to credit risk in the amount of the derivatives' fair value. For the nine swap agreements that have positive fair value, the City has credit exposure to the counterparties as of June 30, 2008. Should the counterparties to these transactions fail to perform according to the terms of the swap contracts, the City faces a maximum loss equivalent to the swaps' \$976,847 fair value. However, because the swap counterparties are also party to other swaps whose fair value is currently negative, the City could use netting provisions to offset the potential loss.

The swap agreements contain varying collateral agreements with counterparties. In general, these agreements require full collateralization of the fair value of the swap should the counterparty's credit rating fall below Baa as issued by Moody's or BBB as issued by Standard and Poor's. Collateral on all swaps is to be in the form of United States Government securities held by the City.

Although the City executes transactions with various counterparties, 11 swaps, approximating 81% of the notional amount of swaps outstanding, are held with one counterparty, rated A+/Aa3. The City holds the remaining five swaps, approximating 19% of the outstanding notional value, with another counterparty, rated AA+/Aa2.

*Basis risk* - The City's variable rate bonds are of three types: remarketed variable rate demand bonds ("VRDBs"), auction rate bonds ("ARBs"), and CPI index bonds. For those swaps associated with VRDBs and ARBs, the City receives a floating rate based on either the SIFMA Index or the one-month LIBOR. For the SIFMA based swaps, the City is exposed to basis risk should the spread between the SIFMA and the VRDBs or ARBs rate change. If a change occurs that results in the spread widening, the expected cost savings may not be realized. As of June 30, 2008, the SIFMA rate for the prior 52-week period ranged from 1.24% to 3.95%, whereas the City's tax-exempt market ranged from 1.15% to 6.10%. For one of the swaps, the City will receive a percent of LIBOR or a percent of LIBOR plus 29.5 basis points, each rate was chosen to closely approximate the City's tax-exempt variable rate bond payments. Because this swap is LIBOR-based, there is an additional degree of basis risk. As of June 30, 2008, LIBOR for the prior 52-weeks ranged from 2.56% to 5.82%, whereas the City's taxable market ranged from 2.33% to 10.00%. For those swaps associated with CPI index bonds, there is no basis risk, because the floating rate on the swaps is identical to the floating rate on the bonds.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

*Interest rate risk* - For those swaps for which the City pays a floating rate and receives fixed rate payments, the City is exposed to interest rate risk. As floating rates increase, the City's expected savings could decrease. The City would, however, benefit from offsetting increases in its earnings on short-term investments, whose return would be expected to go up in a higher interest rate environment.

*Termination risk* - The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If at the time of termination the swap contract has a negative fair value, the City would be liable to the counterparty for that payment.

*New Accounting Pronouncement* - In June 2008, the GASB issued Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments." GASB Statement No. 53 will require that derivative instruments be reported at fair value; further, periodic changes in those fair values for investment derivatives or other derivatives which are ineffective will be reported as a component of investment income. For derivatives which are effective hedging instruments, periodic changes in fair value will be deferred on the statement of net assets. GASB Statement No. 53 is effective July 1, 2009 for the Fund's financial statements for the fiscal year ending June 30, 2010.

**11. Pension Plan**

Classified employees of the Waste Water Utility are required to join the City of Baltimore's Employees' Retirement System (ERS). The ERS is a cost-sharing multiple-employer defined benefit pension plan which provides retirement, disability, and death benefits to plan members and beneficiaries. The plan is managed by a Board of Trustees in accordance with Article 22 of the Baltimore City Code. Plan provisions may be amended only by the City Council. The Waste Water Utility's share of contributions to the plan was \$4,073,000 in 2008, \$3,358,000 in 2007 and \$2,919,000 in 2006. The Waste Water Utility contributed 100% of the required contribution each of the three years. The ERS issues a publicly available financial report that may be obtained by writing to the Baltimore City Retirement Systems, 7 East Redwood Street, 12th Floor, Baltimore, MD 21202-3470.

**12. Other Postemployment Benefits**

Baltimore City administrative policy provides that other postemployment benefits, other than pension benefits, be provided to all employees of the City. These benefits include certain healthcare and life insurance benefits. All employees who retire are eligible to receive these benefits. The City of Baltimore provides other postemployment benefits (OPEB) to all qualified City employees. The OPEB Plan (Plan) is a contributory, single

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

employer defined benefit plan. The benefit and contribution provisions of the Plan are established and may be amended by the City. The Plan provides postemployment healthcare, prescription and life insurance benefits to retirees and their beneficiaries. In order to effectively manage the Plan, the City established an OPEB Trust Fund. All retiree and City contributions are deposited into the Trust Fund and all retiree related health and life insurance benefits are paid from the Trust Fund. The City also contracted with the Board of Trustees of the Employee's Retirement System to act as investment manager for the Trust Fund. BNY Mellon Bank Asset Servicing is the Trust Fund's asset custodian. The Plan does not issue stand alone financial statements; however, the OPEB Trust Fund is included in the City's financial statements as a Trust and Agency Fund.

At June 30, 2008, there were 21,017 City retirees eligible for these benefits. The City reimburses approximately 50% of the premium cost incurred by pre-Medicare retirees and their dependents. The City also reimburses approximately 50% of the cost for Medicare supplement for each retiree or dependent eligible for Medicare. Such benefits are accounted for on a cash basis so that payments during the current year represent benefit coverage for currently retired employees or their beneficiaries.

For fiscal year 2008, the City's total contributions to the Plan were \$183.3 million from its General Fund.

**13. Risk Management**

The Waste Water Utility participates in the City's risk management program. The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 1987, the City established the Risk Management Fund (an internal service fund) to account for and finance its uninsured risks. The City's risk financing techniques include a combination of risk retention through self-insurance and risk transfer through the purchase of commercial insurance. The Risk Management Fund services all claims for risk of loss, including general liability, property and casualty, workers' compensation, unemployment compensation, automobile physical damage and bodily injury, and sundry other risks. Commercial insurance coverage is provided for each property damage claim in excess of \$750,000 with a cap of \$250,000,000. Settled claims have not exceeded this commercial coverage in any of the past three years. The City also provides medical insurance coverage for all employees and retirees. Employees are required to pay a percentage of the annual cost of medical plans, and the remaining costs are paid by the City's internal service fund.

All funds of the City participate and make payments to the Risk Management Fund based on actuarial estimates and historical cost information of the amounts needed to pay prior and current year claims. During fiscal years 2008 and 2007, the Waste Water Utility's share of the City's cost was \$9,191,000 and \$8,488,000, respectively.

**CITY OF BALTIMORE**  
**Waste Water Utility Fund**  
**Notes to the Financial Statements**  
**June 30, 2008**

**14. Commitments and Contingencies**

The Waste Water Utility has received Federal grants in the amount of \$839,000 and \$3,481,000 for fiscal years 2008 and 2007, and State grants of \$1,456,000 and \$7,000,00 for fiscal years 2008 and 2007, respectively. Entitlement to grant resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal and State regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits in accordance with grantors' requirements. Any disallowances as a result of these audits become a liability of the Waste Water Utility. As of June 30, 2008, the Waste Water Utility estimates that no material liabilities will result from such audits.

The Waste Water Utility has entered into a 20-year Sewerage Sludge Disposal Agreement with the Northeast Maryland Waste Disposal Authority in connection with the financing of a sludge composting facility in Baltimore City. The agreement allows the Waste Water Utility to deliver up to approximately 55,000 wet tons of sewerage sludge per year and to pay a tipping fee comparable to alternative methods of sludge disposal currently being used by the Waste Water Utility. The debt service on variable rate bonds is a component of the tipping fee. The Waste Water Utility's current tipping fee expense for delivering sewerage sludge is \$128.69 per wet ton. Payments under the agreement in fiscal year 2008 were \$2,310,000 for approximately 18,000 wet tons. The maximum commitment by the City is 54,750 wet tons per year, and the agreement extends to 2008.

The Waste Water Utility has also entered into 20-year Service Agreements with Wheelabrator Water Technologies Baltimore L.L.C. in connection with the financing of heat drying facilities for processing biosolids at the City's Back River and Patapsco Waste Water Treatment Plants. Under the agreements the Waste Water Utility delivers approximately 20,000 dry tons of biosolids per year at each facility and pays a tipping fee. The debt service on the bonds is a component of the tipping fee. The Waste Water Utility's current tipping fee expense for delivering biosolids is approximately \$506.66 per dry ton. Payments under the agreements in fiscal year 2008 were \$21,345,000. The agreements extend to 2014.

The City has voluntarily entered into a Consent Decree to rehabilitate its aging sewer infrastructure and correct historical overflow mechanisms. The Consent Decree is one of many that the U.S. Department of Justice has currently negotiated with major east coast cities with aged sewer and storm water infrastructures. The City is proactively negotiating to increase its remedial efforts to address discharge and overflow concerns of the State and Federal regulatory agencies. These efforts are ambitious and the costs of the construction and maintenance are estimated to range between \$500 to \$700 million dollars over the next decade and beyond. The City has committed to financing these remedial efforts through a combination of water and waste water revenue bonds in conjunction with all available State and Federal assistance.